INSTITUTIONAL RESEARCH

ROBERTSON STEPHENS & COMPANY

cc: [illegible]

May 5, 1995

Jan Brandt
Steve Case
David Cole
Mike Connors
Jack Davies
Bill Dunn
Miles Gilburne
Richard Hanlon
Ellen Kirsh
Matt Korn
Ted Leonsis
Marc Seriff
Mark Stavisl
Jean Villanu
Mark Walsh
Audrey Weil

AMERICA ONLINE, INC.

(AMER $43-1/4)

Raising Estimates; New Long-Term Model And Price Target; Reiterate Buy

Keith E. Benjamin (415) 693–3285
Sandra Y. Doyle (415) 693–3514

Rating: Buy

Change in . . .	Yes/No	Was	Is
Rating:	No		BUY
EPS 1995E:	No		$0.43
EPS 1996E:	Yes	$0.75	$0.80
EPS 1997E:	Yes	$1.50	$1.60

52-Week Range:	$48–13
FD Shares Outstanding (MM):	44.0
Mkt Capitalization (MM):	$1,903.0
Average Daily Trading Volume (000):	500
3/95 Book Value/Share:	$3.15
3/95 Total Debt/Total Capitalization:	11%
C1995E ROAE:	20%
Price/Book Value:	13.7x
Net Cash/Share:	$0.50
Dividend/Yield:	None
3-Year Secular Growth Rate:	50%

FY June		1995E	1996E	1997E
EPS:	1Q	$0.08A	$0.15	$0.32
	2Q	0.10A*	0.17	0.36
	3Q	0.12A	0.22	0.43
	4Q	0.14	0.25	0.48
	Year	$0.43	$0.80	$1.60
	P/E	–	54.3x	27.1x
	Cal. Yr.	$0.59	$1.16	—
	Cal.Yr. P/E	73.8x	37.4x	—

Revs. ($MM)		1995E	1996E	1997E
	1Q	$54,423A	$180,941	$295,135
	2Q	73,998A	212,276	322,500
	3Q	106,414A	240,813	349,338
	4Q	142,598	267,236	377,000
	Year	$377,434	$901,266	$1,343,973
Market Cap/Revs.:		5.0x	2.1x	1.4x

2-for-1 stock split effective April 27, 1995
** Excludes $42.8mm one-time charge for acquired R&D*

- We recently raised our F1996 and F1997 EPS estimates to $0.80 and $1.60, respectively, to reflect strong subscriber growth and increased usage.
- We believe it may take some time for Microsoft to "catch up" to America Online's level of expertise and infrastructure in the on-line area.
- **As the on-line industry achieves mass market penetration, we believe the average on-line customer, who is pressed for time, likely will value the convenience of packaged services like America Online.**
- **We believe America Online's valuation of less than 30 times our $1.60 F1997 EPS estimate** is justified by growth rates of 200% in recent quarters and possibly conservative estimates suggesting growth slowing to 30% by the end of F1997.

THE COMPANY and INVESTMENT THESIS:

America Online is the largest and fastest growing U.S. provider of consumer on-line information services with more than 2.5 million subscribers. CompuServe is the second largest in the U.S. with 2.0 million users; however it has 3.0 million users worldwide. We estimate Prodigy has about 1.5 million customers. America Online's easy-to-use menu system offers subscribers a wide variety of services including interactive magazines and newspapers, on-line forums for different special interest groups, E-mail, and easy access to a host of databases and on-line communities, including Internet. We believe America Online has attained the critical mass of subscribers, content and marketing alliances to allow it to maintain momentum and reach three million subscribers by July. In our opinion, the cost of this effort should cause earnings growth to be less than revenue growth in F1995, although we expect margins to improve as the service matures.

INVESTMENT RISKS:

Among the risks are that increasing attention and popularity of on-line services is attracting new competitors and has encouraged existing competitors to increase marketing efforts. We believe the company will continue to face efforts by major competitors to gain market share through service pricing and content differentiation. **We believe the market will sustain multiple competitors and that America Online can continue to grow faster than its competitors.** Still, the stock's high multiple leaves it subject to some volatility.

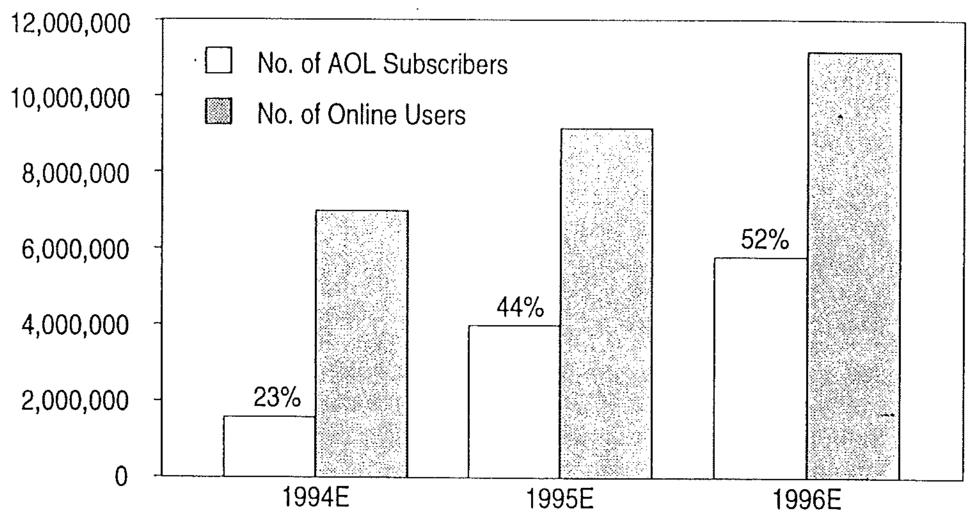
We recently raised our F1996 and F1997 EPS estimates to $0.80 and $1.60, respectively, to reflect strong subscriber growth and increased usage. More importantly, we have a new method for modeling long-term earnings potential. We have struggled for the last year or so trying to figure out a rational way to value America Online's stock and must admit to being more lucky than smart about our Buy recommendation, which has been based primarily on the belief that there were no current barriers to significant positive surprises in the subscriber growth rate. After a few quarters of 200% growth, a stock selling at more than 50 times projected earnings looks reasonably priced. **Rapid home PC penetration appears to remain enough of a driver for sustained industry growth of 50%-plus in 1995 and 1996.**

We saw the service improve substantially over the last year, with competitors Prodigy (S $53-1/4; IBM $93-1/8) and CompuServe (HRB $41-3/8) seeming to slip further behind on a relative basis. Over the last few months, acquisitions, recruiting and the new Bertelsmann joint venture have added some high power management talent and resources to keep the company moving further ahead as a competitive target. But around the corner is the big, unbeatable Microsoft (MSFT $80). Well, almost unbeatable if you don't count Lotus Notes. There is a perception that Microsoft's entry in August could significantly slow America's subscriber growth. We have seen the beta version of the Microsoft Network, which in our opinion is noticeably lacking content. We would not be surprised if, when the Network is launched (scheduled for August), it only contains technical support, minimal content and a Web browser. In contrast, America Online continues to build its content base, including the funding of a handful of content start-ups. It is impossible to understate the execution challenge to keep pace with the changes in the on-line service business and the Herculean effort already shown by the management of America Online. We are willing to give the team the benefit of the doubt in future competitive battles based on its track record of superior execution. Thus we believe it may take some time for Microsoft to "catch up" to America Online's level of expertise and infrastructure in the online area. In addition, we believe it is far more likely that CompuServe's subscriber base (the technology/business users), rather than America Online's (the home/average consumer user), will be attracted to the Microsoft Network.

And then the Internet wave is crashing around us, at least according to the popular press. After actually surfing the maze for a few hours, many find valuable information illusive, although more and more web pages are materializing daily. We believe it is highly unlikely content will remain free or without advertising for very long, counter to the perception that the Internet is like a public library. For example, we would expect magazine publishers to sell their content to both AOL and direct to consumers via Web pages. The question is how much would they expect consumers to pay and how much advertising revenues would they be able to generate online. We strongly believe that some consumers will want their service packaged like AOL and that those will represent the majority of subscribers.

As the on-line industry achieves mass market penetration, we believe the average on-line customer is pressed for time and likely to value the convenience of packaged services like America Online. Prime time for on-line services is right after dinner, when the average generation Xer or 40-something parent is deciding between watching Seinfeld, reading the paper, falling asleep, playing a PC-CD ROM game or jumping on-line for a while. We believe America Online has the right formula to attract and keep this audience.

ON-LINE SERVICE GROWTH



Source: RS & Co. estimates.

The analogy we like to use is to the broadcast networks, which each package content to suit the tastes of the mass market. We think of Prodigy as NBC, pioneering the market before the home PC market was ready and now struggling to keep pace with inferior technology. CompuServe, as CBS, has been successful targeting the technical computer and business user but does not appear aggressive enough to compete against Microsoft. America Online, as the fastest growing, if not the coolest network, seems like Fox. We expect Microsoft to be a strong competitor like ABC. Each of these television networks has maintained an audience (i.e., 50%-plus of prime time viewing), despite competition from cable. We are even seeing the addition of a fifth and sixth network this year from Paramount and Warner. The interesting part is that customers pay nothing for broadcast television, although suffering through commercials is a challenge. That leaves the Internet, which seems analogous to the RCA satellite dish with hundreds of channels to surf. We believe there will be room for at least two, if not six branded on-line services. However, unlike broadcast television, it is difficult to switch between services, particularly once one establishes and uses an E-mail address. As such, we suspect that the gap between the top and bottom on-line services will widen over time. Ultimately, we believe there will be a number of competitors, including America Online and Microsoft. Given America Online's lead time over Microsoft in developing its online service and the consumer nature of its content library and services, we believe the company can maintain its market share and corresponding earnings power despite competition from Microsoft.

Comments on 3Q:95 — America Online Triples Subscriber Base

America Online reported revenues of $106.4 million, a 236% increase over last year, and significantly higher than our estimate of $98.0 million. Excluding one-time costs of $7.9 million, net income quadrupled to $5.1 million or EPS of $0.12, slightly above our estimate of $0.11. The one time expense of $7.9 million is related to the acquisition of Advanced Network & Services, Inc. (ANS), which built the backbone to the Internet and now AOL Net. **During the quarter, America Online**

added a record number of 734,000 new subscribers, leaving the quarter with over 2.3 million subscribers, a 47% increase over the prior December quarter. **America Online added over 200,000 subscribers in April** and just reported total subscribers of 2.5 million. The company believes it will pass the 3 million mark in July 1995 and the 5 million mark by June 1996. EPS numbers reflect a two-for-one stock split effective April 27. **As a result we are raising our F1996 estimate to $0.80 from $0.75 and F1997 estimate to $1.60 from $1.50 to reflect recent strong subscriber growth and higher revenues per subscriber.**

Usage rose sharply, which offset the decrease in pricing for incremental hours from $3.50 to $2.95. Paid hours were up 11% (increasing from 2.46 hours in December to 2.73 hours in 3Q), **boosting revenue per subscriber per month of $17.11. This was much higher than our estimate of $16.25.** Usage time continued its historical pattern and was divided between real-time communication (55%) and news, finance and computing areas (45%). Of the approximate $100 in service revenues, about $75 million represented PC users while $25 million represented Macintosh users. **Average customer life increased from 36 months in December to 39 months in March.** This has significant implications for margin improvement over the next year or so as marketing costs are amortized. Approximately 90% of costs are expensed over the first 12 months. Based on the increased usage per subscriber and retention rate, **average lifetime revenues rose from $612 in 2Q:95 to $667 at the end of 3Q:95. Today's market capitalization per subscriber is approximately $775 per subscriber.**

Gross margins of 39.6% in the quarter were lower than the 42% expected, mostly due the greater than the anticipated growth of subscribers in the quarter. Expenses associated with new subscribers include free trial time and additional customer support time. Also, the anticipated lower pricing for incremental hours put pressure on margins that was mostly offset by greater usage. The increase in high speed modem usage also dampened gross margins since America Online's costs are higher at higher speeds. We expect gross margins will improve over the next year as the company shifts its high speed traffic to AOL Net. AOL Net has 70–75% of its traffic at night, allowing it to sell its daytime capacity alleviating higher costs associated with high speed communications. Marketing costs in the quarter were actually lower than expected as it did not include a 2Market CD-ROM as did the December quarter. The second version of the CD is expected to ship in the 4Q:95. This home shopping service could generate revenues that are not yet reflected in our model. About 37% of revenues came from bundling. Total marketing costs associated with new subscribers was approximately $32 million, of which $16 million was expensed and $16 million was amortized. Deferred subscriber acquisition costs now total $53 million.

The company continues to build its infrastructure, hiring 80 engineers for AOL, adding extra building space and extending its network. America Online also added an amortization of goodwill line for ANS and will amortize the $44 million over the next 10 years. The acquisition of ANS resulted in various shifts on the balance sheet, notably a reduction in cash to approximately $40 million. This is before the recent investment by Bertelsmann of $55 million. The cost of expanding the network will be primarily financed by leasing.

Comments on New Business Model

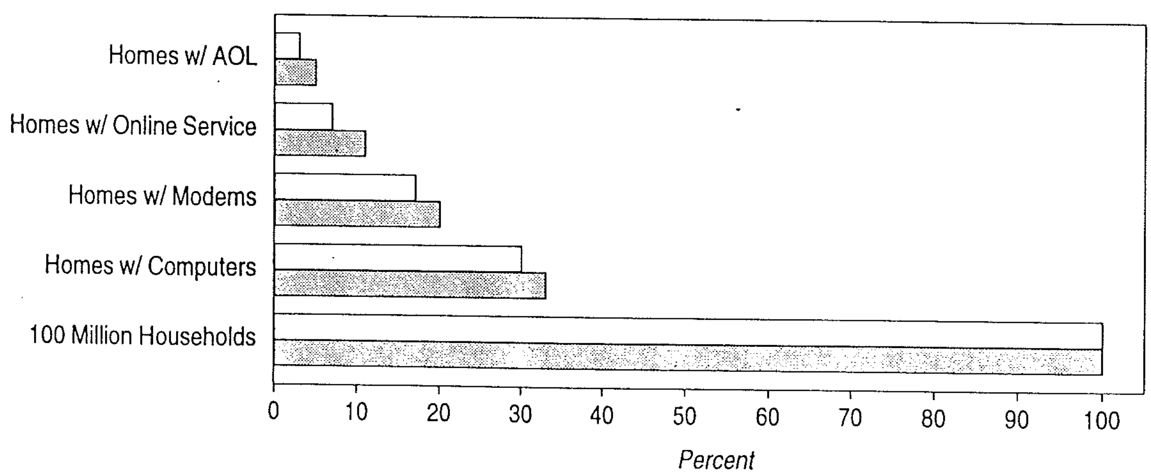
Our EPS estimates for F1995 and F1996 are $0.43 and $0.80, respectively, which seem small relative to a stock trading near $50. The problem is that these earnings are being penalized by accelerating levels of marketing expenses associated with

attracting new subscribers. The company amortizes the subscriber acquisition cost over 15 months, which has resulted in an accumulation of unamortized expenses. As the average subscriber life is now 36 months, we argue that this accounting method is conservative. The retention rate has been improving. The company calculates retention by grouping subscribers into groups based on monthly starts and then uses actual retention rates for each group. The average retention is based on the monthly percentage and is unweighted. Drop-out rates are highest in the first 90 days. Because the most recent months carry as much weight as those of three years ago, the calculation may understate retention. If retention improves, more subscribers will be generating revenues after 15 months without associated marketing costs. Thus cash flow will end up exceeding reported earnings. Unfortunately, in our opinion, reported earnings will remain confusing for the next year or so.

Thus, the challenge with the stock is to figure out a rational target for earnings power, given accounting issues and recent changes in the business model. For example, we have added international, Internet-only, transaction, advertising and business service revenues. Given the industry's and the company's rapid rate of change, we expect the model will evolve substantially and would look forward to questions and suggestions. The following is a review of the some of the logic and guesswork behind the model.

We are using PC penetration into homes as the key driver of industry growth. Home PC sales represent the low end of the range of forecasts we have seen. We assume most new PCs have modems. We have conservatively projected the percentage of new PC buyers at 20% in 1995 and 25% in 1996, based on historic penetration rates. As existing PC owners pick up the on-line habit, we expect cumulative penetration to reach one-third of U.S. households by the end of 1996. We believe the use of on-line services could become more pervasive, and we would not be surprised if the cumulative on-line market reached 50% of U.S. homes with PCs by the end of 1996. Europe, Japan and the rest of the world are further behind the U.S. in terms of home PC use. **In sum, we would not be surprised if U.S. penetration of branded on-line services reached 15 million subscribers by the end of 1996 and 5 million non-U.S. subscribers, compared to our projections of 11 million and 3 million, respectively.**

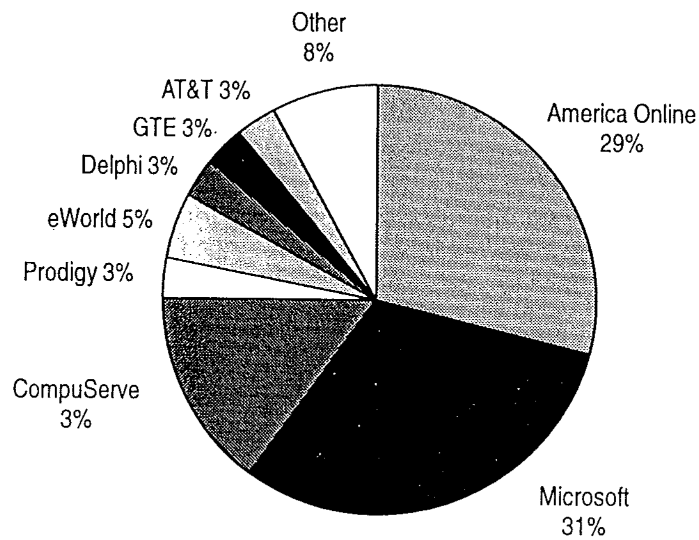
RELATIVELY LOW PENETRATION OF ON-LINE SERVICES



Source: Robertson, Stephens & Company.

The model differentiates between branded and Internet-only services. We anticipate that the majority of home subscribers will access the Internet through a branded service. **Our best guess is that America Online and Microsoft will be the leaders by the end of 1996.** Our Microsoft forecast is based on a forecast of Windows 95 sales into the home, which could prove slower than our assumptions, which are purposely somewhat aggressive, in our view.

RS & CO. MARKET SHARE PROJECTIONS FOR C1997



Source: RS & Co. estimates.

The other key variable is the conversion rate from Windows 95 usage to subscription to the Microsoft Network. We selected 25%, which again may be high during the first year or so of introduction. This is based on our belief that Microsoft will have a difficult time catching up to America Online, given America Online's content base, some of which is exclusive through 1996 (i.e., dozens of magazines). Further, much of America Online's usage is generated in chat and bulletin board areas, which have taken years to build a critical mass of community interest. We suspect the average consumer will try both America Online and Microsoft as he/she buys computers bundled with free trials for each and leans toward the former for some period of time, which we suspect could stretch through 1996. Some consumers may end up keeping both. Microsoft has indicated it plans to charge a relatively low price (i.e., under $5) for the connection and minimal basic services, which will include technical support to use Microsoft programs. The majority of popular content areas will involve additional charges based on usage. It also is possible that the subscription rates may be offset by advertising revenues. The price will be determined by content providers. This appears inherently more expensive than America Online's $9.95 one-price-for-everything for the first five hours. This simple pricing scheme has proven far more popular than the tiered structure used by Prodigy and CompuServe, which have lost considerable share to America Online. It appears that consumers do not like surprises in their bills. If Microsoft's pricing structure proves popular, America Online can copy it. Microsoft's only economic advantage is an inherently lower marketing cost given its ability to bundle the network software with Windows 95.

This leads to our five million subscriber target for America Online by the end of F1996. We assume average revenues fall slightly from more than $17 today to

$15, despite expectations of increased usage. This is to cover possible price competition from Microsoft, although the initial indication is that the opposite will be case. The most substantial variable cost is telephone charges, which are expected to fall from about $0.80 per hour today to $0.50 as volumes increase, particularly over AOLnet, which is being built from the recently acquired ANS company. ANS owns nodes and leases telephone lines. ANS runs the network that remains the backbone to the academic/government Internet.

We have tried to show what marketing costs would be at a relatively steady state by estimating the marketing expense necessary to replace lost subscribers. We have assumed a slight increase in subscriber acquisition costs to $50 from about $45 today, although we would not be surprised if economies of scale allowed a slight reduction.

We have increased the percentage paid to content providers to 50% (may be closer to 25% but we have conservatively used 50%) from around 15% today to reflect the possibility that Microsoft will try to attract content providers by paying more. However, we believe content providers have a strong incentive to sell to as many services as possible rather than sell exclusively to one service.

International

The Bertelsmann joint venture for Europe could provide some significant cost benefits, the most obvious being Bertelsmann's contribution of approximately $100 million in cash. The less obvious benefits are the marketing edge Bertelsmann can provide given its regular contact with some 30 million book/music club members. We do not expect details to be available until the end of the year. However, we have tried to show reasonable parameters. We estimate that pricing should be higher than in the U.S. to reflect the higher costs in Europe, particularly for telephone time. For example, we estimate the telephone cost in Germany may run as high as $3 per hour, compared to less than $1 here. This likely should decline over time based on deregulation, but probably not much before 1998. There are also some cultural issues, such as the relative low use of credit cards, which may require a different payment method than the negative option charges now used here. One option is to set up a negative option charge through banks. Content costs will vary but could perhaps be less because much of the content could come from magazines and newspapers owned by Bertelsmann, the largest publisher in Europe. This provides a significant cultural advantage in making the service appear localized. The biggest advantage may be just being the first strong service offered.

There are about 15 million PCs in European homes and almost no on-line service penetration. We estimate CompuServe has about 300,000 subscribers. The problem is that CompuServe is an expensive American service that appears to appeal only to Europe's intellectual elite. There are also many dumb terminals, which offer minimal service, provided by the telephone companies. We estimate France's Minitel has about 7 million subscribers and Germany's BTX about 850,000 subscribers. One Luxembourg-based consortium has been announced forming Europe On-line (EOL) and is scheduled to launch at year end.

At the end of the year, we believe America Online/Bertelsmann will be the first competitive service offered in Germany, France and the U.K., which together account for most of the PCs in European homes (i.e., about 13 out of 15 million estimated). The next logical countries for 1996 launch are Spain, Italy, Benelux and Scandinavia. Austria and Switzerland may be serviced from Germany. Microsoft appears to be the only other viable competitor, given its ability to leverage worldwide sales of Windows 95.

We expect partnership announcements by the end of the year for Japan, Australia and other countries. The Japanese market is also relatively unpenetrated by PCs and on-line services. We estimate there are only five million PCs in Japanese homes. Nifty Serve, which is a joint venture between CompuServe and Fujitsu, has reported cumulative subscribers of approximately 1 million, although we suspect only about 100,000 to 200,000 paying subscribers remain. In addition, we estimate CompuServe has about 75,000 direct subscribers. Similarly, NEC's PC Van reports about 750,000 subscribers, which we believe really amounts to about 100,000 paying customers.

Shopping

The major addition to the model is the inclusion of new revenues sources. The easiest to understand is the shopping. For example, America Online is setting up a connection to 1–800-FLOWERS. This would appear to be an ideal store for an on-line service because the customer could see pictures of different arrangements. If we assume 5% of subscribers spend $100 each, that would suggest $1,000,000 of revenues per store. We have projected that America Online can "build" 25 stores and charge an 8% "sales" commission. This appears reasonably conservative. Other shops could include music, clothing, etc.

Advertising

The next category, which could represent the largest opportunity, is advertising now that America Online has a critical mass of subscribers. The challenge at this early stage is to estimate pricing. If we look at mature subscription businesses, like newspapers and magazines, advertising usually represents some 75% of revenues. We have tried to estimate revenues to America Online, based on a rough guess on a hit rate for content areas with advertising. However, we expect deals will vary between advertisers. For example, American Express has established a site to offer travel tips, make trip arrangements and sign up new card members. America Online receives a percentage of the fee for new cardmembers. Also, American Express is including advertising and software for America Online in its marketing packages to some of its cardmembers. As such, it is difficult to neatly categorize the revenues and operating income from this arrangement. In terms of the total advertising revenues, we suspect we are being quite conservative. However, any significant increase in advertising revenues would probably be offset by some reduction in subscription revenues.

Internet

We expect many content supplies will need Internet services. For example, we expect many of America Online's content suppliers will also want to establish web sites. The result is similar to a page on America Online that contains information, etc. The difference is that a separate server is required to maintain the web page and connect it to the Internet. America Online is expected to provide a range of services from turnkey packages to consulting advice. One revenue source could be just setting up a web page, which might run $500,000 for designs, software, etc. We are more interested in recurring revenues and have shown potential for ongoing web services, where content suppliers pay America Online on a price-per-hit basis. This is based on the assumption that content suppliers will view web pages as advertising. As secure payment methods are available on the Internet, it is possible that users could be forced to pay for access to web pages. In either case, we believe it is reasonable to price Internet services on usage.

The large opportunity is to provide Internet connections for consumers and businesses. We believe America Online has significant marketing advantages over competitors. Its Internetwork's web browser is superior to those currently available, in our opinion. It has an easy-to-use introduction page that provides a listing of popular services and faster flipping between pages. We have projected 750,000 Internet-only subscribers by the end of 1996. We expect lower margins to be somewhat offset by lower marketing costs. Regardless, we view this as incremental operating income to the core branded business.

Another significant leveraging opportunity is the business Internet access market. America Online is building its own AOLnet in an effort to lower its telephone costs. AOLnet will also allow faster access. Subscribers now can connect at modem speeds of 14.4 kilobits-per-second (Kbps) in most major cities. Faster speeds allow better graphics, pictures, audio, and eventually video and allow much more effective web browsing, which is painfully slow even at 14.4 kbps. The next step is 28.8 Kbps, which should be available shortly. Business customers typically require ISDN, which is 64 Kbps. While Sprint is upgrading its network for faster speeds, America Online is seeking to push even faster. Because it is being geared to support the consumer market, most of the capacity will be used at night. This leaves significant excess capacity during the day. We have estimated the business potential assuming AOLnet is built to cover one-third of America Online's consumer traffic by 1997. We have also assumed relatively low margins as this is more of a commodity business.

Licensing

The final category for incremental revenues is licensing. America Online has already licensed its technology to Apple for eWorld. While the exact terms have never been disclosed, America Online receives a minimum payment starting at about $2 million per year, which already has been exceeded. The formula is based on actual hourly usage. We estimate Apple has more than 100,000 subscribers today and have been somewhat aggressive in projecting more than 500,000 in our 1997 model because Apple is now including modems as standard on its computers, which should help the penetration of on-line services among Apple users.

Business Impact and Valuation

These calculations lead us to estimated earnings of $3.06 per share in F1996 from the core business and potentially $3.60 per share including new businesses. These numbers assume that subscriber growth is halted but revenues grow from higher subscriber usage and from new businesses. **THESE ARE ESTIMATES OF UNDERLYING EARNINGS POTENTIAL, NOT REPORTED EARNINGS.** Assuming subscriber growth continued in C1997, reported earnings would be significantly lower, because of marketing and other costs. However, we believe reported C1997 earnings could approach $2 per share.

VALUATION: **We believe the valuation of less than 30 times our estimated EPS of $1.60 for fiscal 1997** is justified by growth rates of 200% in recent quarters and possibly conservative estimates suggesting growth slowing to 30% by the end of F1997.

Any stock at this valuation level clearly invites controversy. One concern is that some "insiders" have been effectively selling stock. Looking at the executives and directors, year-end sales appear to be in line with historic patterns for taxes, etc. The Tribune sold 400,000 shares and now holds 2.4 million. CMG Information Services sold 700,000 shares and now holds 720,000 shares from the sale of its software company to America Online. CMG developed the web browser that will be called InternetWorks. Apple has a warrant for approximately two million shares, which it has effectively hedged through the creation of an artificial convertible security. Sprint is considering a similar strategy for hedging its 1.8 million warrants.

Based on our projection for earnings power for C1997 (i.e., assuming subscriber growth is artificially frozen) of $3.60 per share and a multiple of 28 times, our target price is $100 per share. The multiple is based on our expectation of potential growth of revenues per subscriber. This estimates are based solely on U.S. earnings and include estimated operating losses from investments in international on-line services.

We believe the biggest challenge for the stock will be the perception that Microsoft's entry could significantly slow America Online's subscriber growth starting in August. We believe consumers will try both and be more likely to select America Online. However, it may take until September or October to show proof. As such, the stock could fall under pressure as August approaches. In the meantime, we expect continued strong subscriber growth, particularly associated with America Online's new Internetworks web browser, will push the stock forward.

ACTION NOW: We maintain and emphasize our Buy rating.

COMING EVENTS: **The final version of the Web browser is expected to be available for downloading as early as next week.** The stand-alone Internetworks product should be launched in June or July. A preview was made available last week. We are quite impressed by its ease-of-use and faster speed (due to compression software) relative to competing Web browsers. We had been slightly concerned by Prodigy's recent success using its browser to add subscribers after a long period of slow to negligible subscriber growth. However, America Online's subscriber growth was undiminished in April and should be helped in May by its new browser.

ON-LINE SERVICE MARKET PROJECTIONS AND ASSUMPTIONS FOR F1996

	U.S.	Europe	Japan	ROW
On-line Users @ End 1994	5,000,000	750,000	500,000	500,000
New PCs in Homes in 1995	8,000,000	4,000,000	2,000,000	4,000,000
Percentage New PCs Going Online	20%	6%	5%	3%
Old PCs in Homes at End 1994	22,000,000	14,000,000	5,000,000	10,000,000
Percentage Old PCs Going Online	5%	1%	1%	1%
New On-line Subscribers in 1995	2,700,000	360,000	140,000	220,000
On-line Users @ End 1995	7,700,000	1,110,000	640,000	720,000
New PCs in Homes in 1996	8,000,000	4,000,000	4,000,000	4,000,000
Percentage New PCs Going On-line	25%	5%	3%	3%
PCs in Homes at End 1995	30,000,000	18,000,000	7,000,000	14,000,000
Percentage Old PCs Going On-line	5%	2%	1%	1%
New On-line Subscribers in 1996	3,500,000	470,000	190,000	260,000
PCs in Home at End 1996	33,500,000	18,470,000	7,190,000	14,260,000
Percentage PCs on Branded Service	33%	9%	12%	7%
Branded On-line Users @ End 1996	11,200,000	1,580,000	830,000	980,000
AMERICA ONLINE	**30%**	**30%**	**30%**	**30%**
Microsoft	33%	25%	20%	7%
CompuServe	15%	15%	15%	15%
Prodigy	3%	0%	0%	0%
eWorld	5%	5%	5%	5%
Delphi	3%	5%	5%	5%
GTE	3%	3%	3%	3%
AT&T	3%	3%	3%	3%
Other	8%	17%	22%	35%
% New PCs in 1995 Including Win95	25%	25%	25%	25%
% Old PCs from 1994 Buying Win95	10%	10%	10%	10%
1995 Home Purchases of Windows95	4,200,000	2,400,000	1,000,000	2,000,000
% New PCs in 1996 Including Win95	95%	95%	95%	95%
% Old PCs from 1995 Buying Win95	10%	10%	10%	10%
1996 Home Purchases of Windows95	10,600,000	5,600,000	4,500,000	5,200,000
Penetration of Network	25%	5%	3%	1%
Microsoft Network Subscribers	3,700,000	400,000	165,000	72,000
Internet-only Consumers	3,350,000	554,100	143,800	142,600
Internet-only As % PC Base	10%	3%	2%	1%

Source: RS & Co. estimates.

AMERICA ONLINE PROJECTIONS FOR F1996

Core Business	U.S.	Europe	Japan	ROW
Number of Branded Subscribers	5,000,000	1,000,000	500,000	500,000
Monthly Revenue Per Subscriber	$15.00	$20.00	$20.00	$20.00
ANNUAL REVENUES	$900,000,000	$240,000,000	$120,000,000	$120,000,000
Average Hours Per Month	6	6	6	6
Time in Content Areas	20%	20%	20%	20%
Time in Sponsored Content Areas	20%	20%	20%	20%
Time in Chat Areas	25%	25%	25%	25%
Time Surfing Internet	35%	35%	35%	35%
Average Revenue Per Hour	$2.50	$3.33	$3.33	$3.33
Telephone Cost Per Hour	$0.50	$2.00	$2.00	$2.00
Variable Telephone Costs	$180,000,000	$144,000,000	$72,000,000	$72,000,000
Fixed Network Costs	$135,000,000	$48,000,000	$24,000,000	$24,000,000
As % Subscriber Revenues	15%	20%	20%	20%
Retention Rate	80%	80%	80%	80%
Cost of Adding New Subscriber	$50.00	$50.00	$50.00	$50.00
Cost of Maintaining Subscriber Base	$50,000,000	$10,000,000	$5,000,000	$5,000,000
Content Cost as % of Related Revenues	50%	50%	50%	50%
Annual Content Costs	$90,000,000	$24,000,000	$12,000,000	$12,000,000
As % Subscriber Revenues	10%	10%	10%	10%
MARKETING COSTS	$90,000,000	$48,000,000	$24,000,000	$24,000,000
As % Subscriber Revenues	10%	20%	20%	20%
Research & Development	$36,000,000	$9,600,000	$4,800,000	$4,800,000
As % Subscriber Revenues	4%	4%	4%	4%
General & Administrative	$72,000,000	$19,200,000	$9,600,000	$9,600,000
As % Subscriber Revenues	8%	8%	8%	8%
OPERATING INCOME	$247,000,000	$(62,800,000)	$(31,400,000)	$(31,400,000)
As % Subscriber Revenues	27%	(26)%	(26)%	(26)%
Joint Venture Contribution To Cost		$100,000,000	$100,000,000	$100,000,000
Percentage Payout To JV Partner		50%	50%	50%
Payout to JV Partner		$(31,400,000)	$(15,700,000)	$(15,700,000)
Non-U.S. Operating Income to AOL		$(31,400,000)	$(15,700,000)	$(15,700,000)

Source: RS & Co. estimates.

AMERICA ONLINE PROJECTIONS FOR F1996

Additional Business Potential — Shopping	U.S.
Number of Stores	25
Average Revenue Per Store	$1,000,000
Annual Retail Revenues	$25,000,000
% of Shopping Subscribers	5%
No. of On-line Shoppers	$250,000
Average Revenue Per Subscriber	$100
Commission to AOL	8%
Revenue to AOL	$2,000,000
Cost to AOL to Maintain Stores	$1,000,000
Store Operating Income to AOL	$1,000,000
Number of Advertising Sponsors	100
Cost of Site on AOL	$150,000
Number Hours Sponsored Content	6,000,000
Number of Hits per Hour	15
Total Number of Hits	90,000,000
Cost per Hit	$0.17
Annual Advertising Revenues to AOL	$15,000,000
Cost to AOL to Maintain Content Sites	$5,000,000
Content Operating Income to AOL	$10,000,000
Average Hits per Web Site	1,000,000
Price Per Hit	$1.00
Revenues to Web Site Owner	$1,000,000
Percentage to AOL	10%
Revenues to AOL per Web Site	$100,000
Number of Web Sites Maintained	100
Revenues to AOL	$10,000,000
Cost to AOL to Maintain Web Sites	$1,000,000
Web Operating Income to AOL	$9,000,000

Source: RS & Co. estimates.

Additional Business Potential — Internet	U.S.
INTERNET FOR BUSINESS	
Annual Capacity Needed (HOURS)	360,000,000
Percentage From AOLnet	33%
Percentage Evening Usage	70%
Hours Available During Daytime	84,000,000
Price Per Hour For Corporate Usage	$0.75
Annual Corporate Internet Revenues	$63,000,000
Telephone Cost Per Hour	$0.50
Annual Telephone Costs	$42,000,000
Business Internet Operating Income	$21,000,000
INTERNET FOR CONSUMERS	
Number of Internet Only Subscribers	750,000
Monthly Revenue Per Subscriber	$15.00
Annual Consumer Internet Revenues	$135,000,000
Average Hours Per Month	15
Average Revenues Per Hour	$1.00
Telephone Cost Per Hour	$0.50
Annual Telephone Costs	$67,500,000
Retention Rate	80%
Cost of Adding New Subscriber	$20
Cost of Maintaining Subscriber Base	$3,000,000
Consumer Internet Operating Income	$64,500,000
Number of eWorld Subscribers	560,000
Average Hourly Usage Per Month	5
AOL Royalty Per Hour	$0.25
Estimated Royalty Revenues	$8,400,000
U.S. INCREMENTAL OPERATING INCOME	$105,900,000
Total U.S. Operating Income	$352,900,000
Interest & Other Income	$100,000
Total International Operating Losses	$(62,800,000)
Pretax Income	$290,200,000
TAX RATE	38%
Net Income	$179,924,000
Shares Outstanding	50,000,000
Core Business EPS	**$3.06**
Potential EPS (Including Shopping and Internet)	**$3.60**

Source: RS & Co. estimates.

AMERICA ONLINE
QUARTERLY EARNINGS OUTLOOK
($ in thousands except for per share and sub data)

FY June	Q1A*	Q2A**	Q3A	Q4E	1995E	Q1E	Q2E	Q3E	Q4E	1996E	Q1E	Q2E	Q3E	Q4E	1997E
	1995E					1996E					1997E				
Net Service Revenues	$50,056	$69,712	$99,814	$134,098	$353,681	$165,341	$193,976	$221,213	$245,936	$826,466	$270,135	$294,000	$316,838	$337,500	$1,218,473
Redgate (Net of Eliminations)	$3,640	$3,300	$4,600	$3,000	$14,540	$6,000	$6,000	$6,000	$6,000	$24,000	$7,000	$8,500	$10,000	$12,000	$37,500
Other (AAPL Licensing)	727	986	1,000	2,000	4,713	1,000	1,100	1,100	1,100	4,300	1,500	1,500	1,500	1,500	6,000
Internet	0	0	1,000	3,500	4,500	8,600	11,200	12,500	14,200	46,500	16,500	18,500	21,000	26,000	82,000
Total Revenues	***$54,423***	***$73,998***	***$106,414***	***$142,598***	***$377,434***	***$180,941***	***$212,276***	***$240,813***	***$267,236***	***$901,266***	***$295,135***	***$322,500***	***$349,338***	***$377,000***	***$1,343,973***
Cost of Revenues	31,955	41,506	65,100	85,044	223,605	106,165	124,594	141,191	155,690	527,640	167,959	182,810	196,737	212,533	760,039
Gross Profit	**$22,468**	**$32,492**	**$41,314**	**$57,554**	**$158,845**	**$74,776**	**$87,682**	**$99,622**	**$111,547**	**$373,627**	**$127,176**	**$139,691**	**$152,601**	**$164,467**	**$583,934**
Marketing	11,295	15,593	19,642	26,820	73,349	38,855	45,778	50,879	56,565	192,078	63,212	68,502	72,239	76,781	280,734
Development	1,757	3,377	3,453	5,914	14,500	9,094	10,669	12,167	13,526	45,456	15,263	16,611	18,218	19,575	69,667
G&A	5,280	6,408	10,297	13,960	35,944	15,395	18,152	20,194	22,205	75,946	24,203	26,690	28,844	31,208	110,945
Amortization of Goodwill	–	–	551	1,100	1,651	1,100	1,100	1,100	1,100	4,400	1,100	1,100	1,100	1,100	4,400
Operating Income	***$4,136***	***$7,114***	***$7,373***	***$9,760***	***$33,401***	***$10,332***	***$11,983***	***$15,282***	***$18,150***	***$55,747***	***$23,398***	***$26,788***	***$32,200***	***$35,803***	***$118,189***
Interest Income	688	750	814	700	2,952	600	600	600	600	2,400	500	500	500	500	2,000
Pretax Income	4,824	7,864	8,188	10,460	31,336	10,932	12,583	15,882	18,750	58,147	23,898	27,288	32,700	36,303	120,189
Income Tax	1,848	4,060	3,452	3,975	13,334	4,154	4,781	6,035	7,125	22,096	9,081	10,369	12,426	13,795	45,672
Net Income	***$2,976***	***$3,804***	***$4,736***	***$6,485***	***$18,002***	***$6,778***	***$7,801***	***$9,847***	***$11,625***	***$36,051***	***$14,817***	***$16,918***	***$20,274***	***$22,508***	***$74,517***
EPS	***$0.08***	***$0.10***	***$0.12***	***$0.14***	***$0.43***	***$0.15***	***$0.17***	***$0.22***	***$0.25***	***$0.80***	***$0.32***	***$0.36***	***$0.43***	***$0.48***	***$1.60***
Shares Outstanding	37,076	39,840	44,000	46,000	41,729	44,600	45,000	45,400	45,800	45,200	46,000	46,400	46,800	47,200	46,600
Ending Subscribers	1,158,000	1,578,000	2,313,000	2,915,000	2,915,000	3,475,000	4,000,000	4,500,000	4,950,000	4,950,000	5,400,000	5,800,000	6,100,000	6,400,000	6,400,000
Average Subscribers	1,030,500	1,368,000	1,945,500	2,614,000	1,909,000	3,195,000	3,737,500	4,250,000	4,725,000	3,932,500	5,175,000	5,600,000	5,950,000	6,250,000	5,675,000
Monthly Rev. Per Avg. Sub.	$16.21	$17.00	$17.11	$17.10	$16.86	$17.25	$17.30	$17.35	$17.35	$17.31	$17.40	$17.50	$17.75	$18.00	$17.66
Avg No. of Subs Added per Month	85,000	140,000	245,000	200,667	167,667	186,667	175,000	166,667	150,000	169,583	150,000	133,333	100,000	100,000	120,833
% of Service Revenues															
Gross Margin	41.8	44.5	39.6	39.5	41.4	41.0	41.0	41.1	41.5	41.2	42.8	43.1	43.4	43.4	43.2
Marketing	22.6	22.4	19.7	20.0	20.7	23.5	23.6	23.0	23.0	23.3	23.4	23.3	22.8	22.8	23.1
% of Total Revenues															
Development	3.2	4.6	3.2	4.0	4.1	5.5	5.5	5.5	5.5	5.5	5.7	5.7	5.8	5.8	5.7
G&A	9.7	8.7	9.7	10.0	9.5	8.8	8.8	8.6	8.5	8.7	8.4	8.5	8.5	8.6	8.5
Operating Income	7.6	9.6	6.9	6.8	8.8	5.7	5.6	6.3	6.8	6.2	7.9	8.3	9.2	9.5	8.8
Pretax Income	8.9	10.6	7.7	7.3	8.3	6.0	5.9	6.6	7.0	6.5	8.1	8.5	9.4	9.6	8.9
Effective Tax Rate	38.3	51.6	42.2	38.0	42.6	38.0	38.0	38.0	38.0	38.0	38.0	38.0	38.0	38.0	38.0
Net Income	5.5	5.1	4.5	4.5	4.8	3.7	3.7	4.1	4.3	4.0	5.0	5.2	5.8	6.0	5.5
Y/Y Growth Rate															
Net Service Revenue	250.1	243.5	245.9	257.1	250.2	230.3	178.3	121.6	83.4	133.7	63.4	51.6	43.2	37.2	47.4
Total Revenue	185.3	244.2	264.6	277.6	251.0	232.5	186.9	126.3	87.4	138.8	63.1	51.9	45.1	41.1	49.1
Operating Income	678.9	344.9	203.3	249.6	354.2	149.8	68.4	107.3	86.0	66.9	126.5	123.5	110.7	97.3	112.0
EPS	716.9	141.9	128.3	128.9	155.8	89.3	81.6	80.7	80.0	84.5	112.0	110.3	99.7	87.9	100.6
Average Subscribers	199.2	197.2	230.4	222.8	222.8	200.1	153.5	94.6	69.8	69.8	55.4	45.0	35.6	29.3	29.3

Source: Company reports and RS&Co. estimate

* Extraordinary merger expense of $1.7 million, bordinary = $.07

** Excludes $42.8 mm charge for acquired R&D ·ge, reported EPS was ($2.49)

*** Reflects 2:1 stock split effective April 27, 199

Note: Robertson, Stephens & Company maintains a market in the shares of American Online, Inc.; Apple Computer, Inc.; Lotus Development Corporation; and Microsoft Corporation and has been a comanaging underwriter for American Online within the past three years.

Unless otherwise noted, prices are as of Friday, May 5, 1995.